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MEMORANDUM FOR THE RECORD

13 July 1951

SUBJECT: Conference With Navy on Profit Margins

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1. Today [REDACTED] and the undersigned conferred at the Main Navy Building with Mr. H. B. Christenat, of the Office of Navy Materiel, Executive Office of the Secretary. In his position Mr. Christenat is engaged at a high level in matters of policy and coordination concerning the negotiation of contracts throughout the Navy.

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2. The current demands of several companies, particularly [REDACTED] for profit margins in excess of those generally granted by this Agency were outlined by [REDACTED] Mr. Christenat stated that the ASPR Conference has been considering the costs and profits of a representative list of six large companies doing considerable business with the Armed Services, including [REDACTED]

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[REDACTED] A committee was appointed, on which Mr. Christenat served, to make a study of [REDACTED] Some three months were devoted to this by the committee and their report is presently being studied by the three Secretaries. Consequently, it cannot be released. However, the committee found a tendency to pyramid profits by ordering components from various divisions of the company. The committee recommends in its report ranges of fixed fees and profit margins to be paid [REDACTED] by the Armed Services.

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3. The Navy does not set maximum profit percentages which its negotiators may not exceed in making fixed price contracts. The profit margin will vary greatly depending upon the amount of know-how, skill, and risk involved. For example, it has been found that many contracts for electronic equipment on which a high rate of profit was formerly paid really involve largely an assembly operation. Hence, it is always necessary to examine the contractor's cost breakdown carefully to determine the sums to be spent for purchased components, materials, labor, etc. Subcontracting is also a question to be considered, although the contractor's contribution there is usually much more than in the purchase of ready-made parts. In connection with subcontracting, Mr. Christenat observed that the Navy often encourages and even requires that a certain fraction of the order be subcontracted. This is in order to develop new sources of supply, preferably decentralized geographically.

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4. Since the Navy does not set definite maximum profit margins, it must and does constantly interchange information between the Bureaus on contracts negotiated. There is a central unit in the Office of Navy Materiel which handles this. In addition, the chief negotiators for the various Bureaus meet once a week in the office of Mr. Christenat to exchange ideas and formulate policies. Interchange of information also goes on between the various armed services, each passing on to the others continuously a record of contracts entered into and the essential conditions contained.

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5. The Navy in its fixed price contracts with [REDACTED] company has been allowing from 11% to 12.6% profit on cost, with no provision for upward revision of the price on redetermination. Mr. Christenat expressed the opinion that the 25% upward revision provision asked of this Agency by [REDACTED] substantially removes the element of risk from the contract and hence the 11.5% profit seems excessive, this being a production contract. However, he stated that the Navy considers [REDACTED] to be a good, low-cost manufacturer, and pointed out that the Government is generally more interested in overall cost of the product than in the percentage of profit involved.

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6. Mr. Christenat remarked that on occasion the Navy has been unable to reach an agreement with contractors on profit margins and has ceased doing business with them as a result. He had in mind particularly the case of one large corporation, which subsequently came back and reversed its position. The Navy can and does hold this threat over contractors. It was pointed out, however, that CIA is not in such a strong position in this regard since the volume of its procurement is so much smaller. Also, it may be pointed out parenthetically, although it was not discussed at the meeting, that CIA negotiators are frequently handicapped in seeking other sources of supply by the immediate need of the requisitioning office for the equipment or by its desire for one special manufacturer's article.

7. Mr. Christenat said that he would be glad to exchange information in the future when not otherwise engaged and would consider the establishment of a contact point for CIA to obtain information of this nature and advise [REDACTED]

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